

**RESPONSE OF JAMES M. COLE
TO A LETTER FROM SENATORS GRASSLEY AND COBURN
DATED NOVEMBER 9, 2010
CONTAINING SUPPLEMENTARY QUESTIONS FOR THE RECORD**

QUESTION (1): In response to Senator Grassley's question 20(c), which asked if you ever allowed AIG Management to revise or review any of your reports prior to submission to the SEC or DOJ, you stated, "it is standard practice in the private sector for a corporation's internal audit and compliance committees to review annual reports by external auditors." Further, you responded, "In the public sector, the General Accounting Office (sic) and Inspectors General at federal agencies typically engage in a similar process." Finally, you added, "While I followed this standard practice. I was under no obligation to accept any input from AIG, and I routinely rejected revisions suggested by AIG."

- a.** Your response indicates you allowed AIG Management to revise and review your reports prior to submission to the DOJ and SEC. What types of revisions did AIG routinely make? What types of revisions did you routinely reject? Why did you agree to these revisions? Did you ever provide a copy of the requested revisions to the SEC or DOJ? Why or why not?

RESPONSE: In the first phase of the monitoring project of AIG, I was charged with a retroactive review of all AIG transactions with third parties from January 1, 2000 through December 7, 2004 to determine whether any of those transactions were used by AIG customers to improperly report their own financial condition. My review also covered the newly-created internal Transaction Review Committee at AIG and policies and procedures at one of AIG's business units concerning the use of retroactive insurance policies. As required by the Consent Order, my team generated three types of documents as part of the first monitoring assignment: (i) periodic reports to the SEC, the DOJ, and AIG that included a factual description of the third party transactions we were examining and the process we were using to conduct our review of these transactions; (ii) notifications to the SEC and AIG containing specific findings of improper financial reporting discovered during the course of this review; and (iii) periodic reports to the SEC, the DOJ and AIG concerning our review and evaluation of the Transaction Review Committee and the policies and procedures concerning retroactive insurance policies. It was important that the facts on which my reports were based were completely accurate. Therefore, to strengthen the accuracy of my reports, I provided drafts of the reports and notifications to AIG so that the company could provide additional facts or make factual corrections. The SEC and the DOJ were fully aware of this practice.

The suggestions offered by AIG included the correct identification of AIG employees, the dates materials were submitted or events took place, and the descriptions of activities in which AIG had engaged that were pertinent to the subject of the reports. We never accepted a factual change suggested by AIG without first independently verifying the accuracy of AIG's description. With respect to the notifications, AIG was permitted to review and comment on the factual underpinnings and the application of the complex accounting rules. However, as with the reports,

we only accepted revisions if they were independently verified by my team. AIG's feedback never resulted in my team not issuing a notification; all draft notifications were issued after being finalized.

In one instance, we did withdraw a notification after it was issued in order to give it further consideration based on post-notification conversations with AIG about the accounting rules applicable to the matter. We notified the SEC of this withdrawal. At a latter time, after our further review, we issued another notification on the same transaction, citing a different accounting rule as the basis for the finding.

In the second phase of the monitoring project, I was tasked with making recommendations to AIG on measures they should adopt prospectively in order to achieve best practices for improving regulatory compliance and financial reporting requirements that applied to the company. Because the court's Consent Order required me to confer with AIG in order to reach an agreement on the recommendations, I shared the draft recommendations with AIG. In the course of those conferences, AIG made a few practical suggestions that were accepted and the recommendations were adopted and agreed to by me and AIG. The SEC and the New York Attorney General's office were informed of this process and it was described in the Report issued on April 10, 2008.^{1/} Following the issuance of the recommendations, my team prepared reports focused on AIG's implementation of our recommendations. AIG was shown drafts of these reports and offered comments about details of factual matters contained therein that were of the same nature as the comments it gave for the earlier reports. AIG would mostly offer suggestions to the section of the Report entitled "AIG Response." On a few occasions, AIG would suggest a stylistic change of phrasing in the analytical section of the report. Sometimes they made a valid point and their suggestion was incorporated, but mostly these suggestions were rejected.

While the SEC, the DOJ, and the New York Attorney General were aware of this practice, they never asked for a copy of the revisions and, as such, none were provided. These agencies were aware that I only accepted the company's suggestions when necessary to make my reports as accurate and complete as possible, and only after my team independently verified factual assertions by the company.

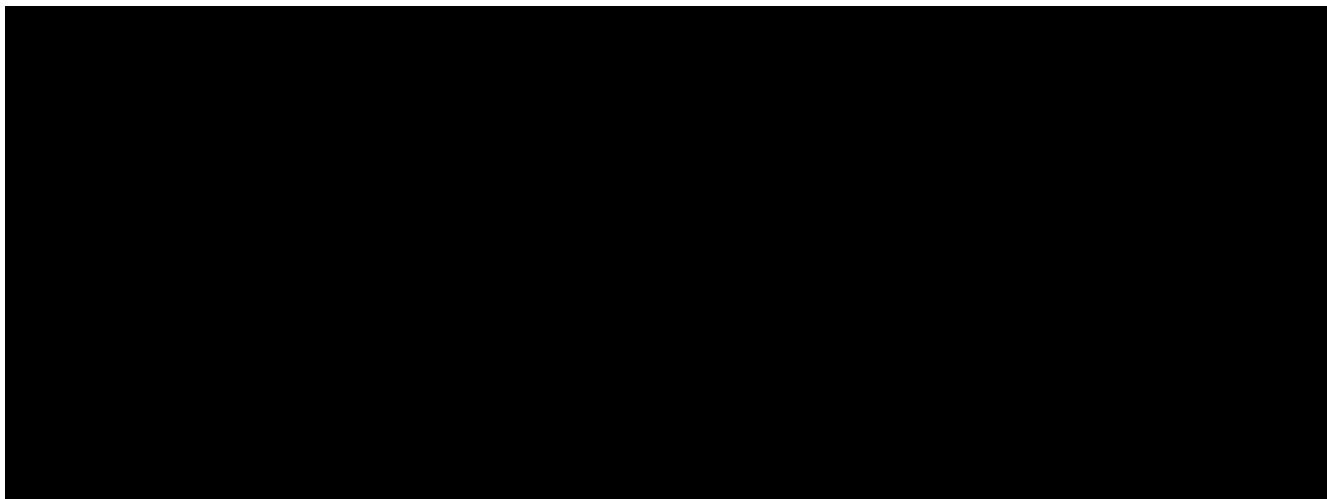
b. Your response states that one reason you allowed AIG to revise your reports was that the GAO and Inspectors General allow agencies to review and comment before a report is issued. While this statement is true, the standard practice of both the GAO and Inspectors General is to make all revisions and comments public and included as an appendix to the actual report. This is done to provide transparency for the reader of the report. Why did you refuse to incorporate a section with the response from AIG in a separate appendix similar to how GAO and Inspectors General do? Did you retain copies of the edits made or requested by AIG to your reports? If so, did you ever share those requested changes with the DOJ or SEC? Were DOJ or the SEC aware of the fact that AIG had made revisions to the reports before they received them? If not, why not?

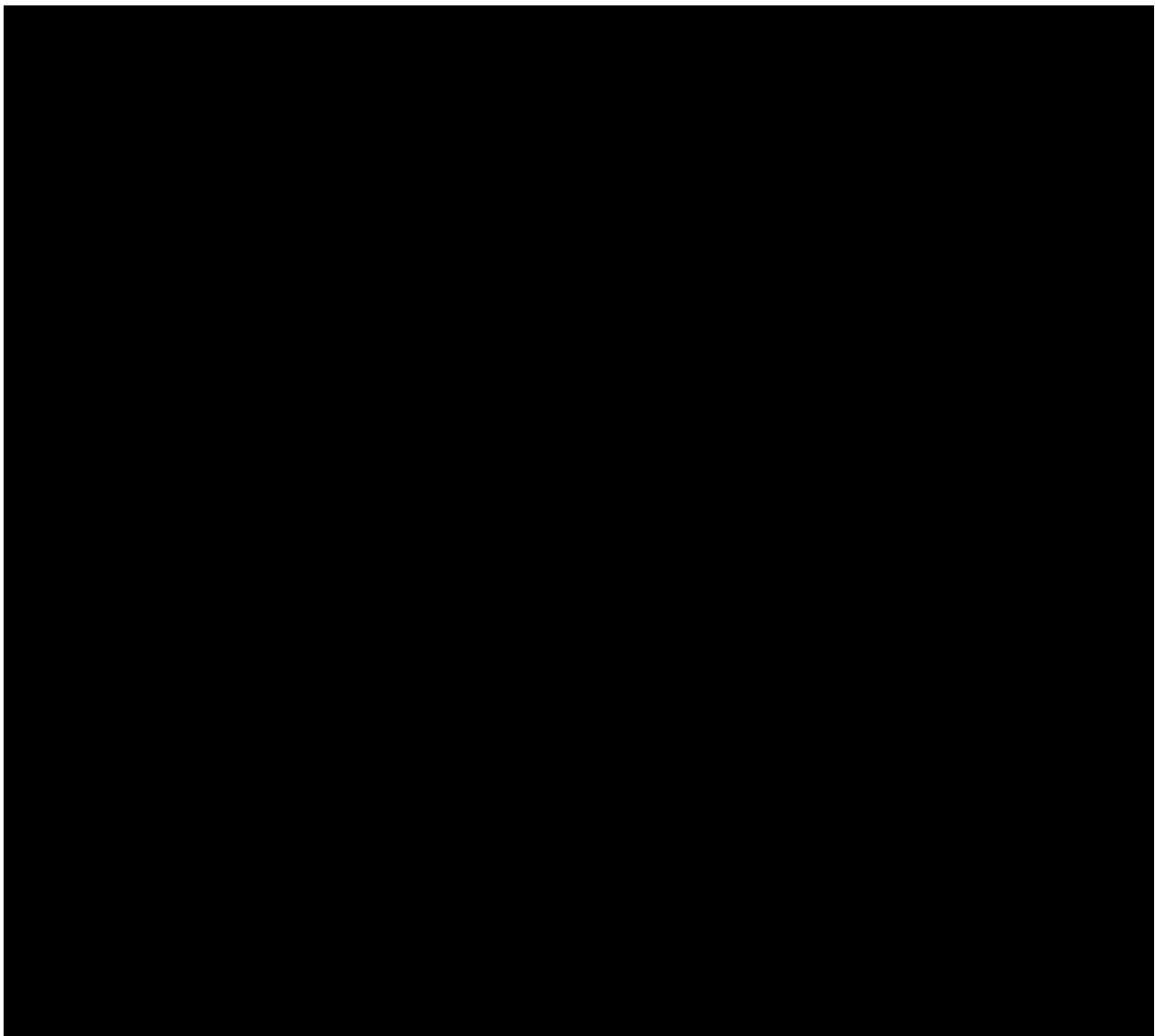
^{1/} The DOJ was not involved in the second monitoring project, but the New York Attorney General's Office was involved.

RESPONSE: When GAO or outside auditors include comments or requested revisions to a report as an appendix, it is frequently because the author of the comment or requested revision disagrees with the conclusion of the report. The appendix is presented to offer the reader a description of the opposing points of view. AIG's suggestions did not indicate any disagreement with the *conclusions* of my reports. Rather, because AIG's suggested corrections were merely factual and they were incorporated only if my team verified them, or they were clearly identified as a representation only by AIG (not me), I did not believe that a detailed presentation of this factual review process was necessary to an understanding of each party's position. Documents reflecting AIG's suggested edits to the Reports were available to the SEC, the DOJ and the New York Attorney General's office, but the agencies – which were aware of this practice – did not request such documents.

QUESTION (2): In response to Senator Grassley's question 20(g), you stated that you were not denied access to documents, information, or witnesses. Did you ever establish a mechanism to allow AIG employees to provide you with anonymous complaints or concerns? Did you ever ask AIG to establish a secure whistleblower hotline that would allow you to obtain information from AIG employees independent of AIG Management or attorneys? If not, did you ever consider such an anonymous mechanism? If not, why not?

RESPONSE: In the course of my work as an independent monitor of AIG, I recommended, and the company established, a number of avenues for whistleblowers to anonymously report misconduct. My team periodically reviewed those reports. In addition, my name and law firm were prominently known to AIG employees, and my staff and I provided the employees we encountered with our business cards and contact information. We informed AIG employees that we would welcome any information they wanted to provide, and that such information would not be shared with AIG. While there was no separate hotline for such reporting to me personally, AIG employees sought us out and talked to us confidentially. We also privately reached out to employees whom we believed had information that was pertinent to our responsibilities. We did not disclose to AIG any of those private encounters or interviews.





QUESTION (4): In response to Senator Grassley's question 20(h), you stated that you approved a recommendation, known as recommendation EC-2, of the Derivatives Review Committee created by AIG that exempted AIG-FP from the independent Derivatives Review Committee in favor of letting AIG-FP independently review its own transactions because, "this dual system was developed in conjunction with AIG's independent accountants and, once implemented, was found to comply with GAAP. As a result, at the end of 2006, the independent accountants opined that AIG had remediated its material weakness in this area." You added, "After reviewing the process and information [from AIG's independent accountants you] included it in my 2007 recommendations."

- a. Notwithstanding the "independent accountants" recommendation, did you believe in your experience as an "independent consultant" that allowing AIG-FP to review its own transactions was a model practice for independent review? Isn't allowing one to self-police the exact opposite of an independent review? Do you believe that an

organization independently monitoring oneself provides the same level of objectivity that an outside, disinterested third party can offer? If so, please state reasons you believe this.

RESPONSE: It must be understood that none of my recommendations would have resulted in AIG-FP monitoring itself. The purpose of the recommendation at issue was solely to ensure the proper application of the hedge accounting rules applicable to derivative transactions. As stated in my answer to question 20(h) previously submitted to me by Senator Grassley, this complex process involved matching thousands of transactions in order to qualify for this accounting treatment. It did not involve an evaluation of the wisdom or risk aspects of entering into the derivative transactions. The scope of the work I was legally authorized to conduct under the Consent Order did not include an evaluation of financial risk. Under my recommendation, AIG-FP's application of the hedge accounting rules to its derivative transactions was to be monitored independently. Due to the sheer volume of transactions at issue, the monitoring could not be accomplished by human beings and could only be accomplished by an automated system. The automated system was validated both by AIG's independent outside auditors and my consultants, and provided an objective, independent mechanism for ensuring that the transactions qualified for the accounting treatment under the rules related to derivative hedge accounting. This function could not have been assigned to the Derivatives Committee because it would not have been capable of reviewing the appropriateness of the matching needed for the thousands of AIG-FP transactions to qualify for hedge accounting.

b. At the time you based your reliance on the "independent accountants" recommendations, were you aware that AIG was the single largest client for PricewaterhouseCoopers (PwC)? Were you aware that PwC was selected for an audit by the Public Company Accounting Oversight Board (PCAOB) for an inspection because of its 2007 audit of AIG? Did you consider waiting for the results of that inspection prior to rubber stamping the recommendation from PwC to allow AIG-FP to essentially self-regulate as its own independent monitor?

RESPONSE: In 2007 when I issued the recommendation at issue, PwC had not been selected for an audit by the PCAOB. I was not aware at that time that AIG was PwC's largest client, although I did know that AIG was a significant PwC client. It is important to note that in its 2004 audit of AIG, PwC found a material weakness in AIG-FP's hedge accounting system and AIG's proposed remedy was to institute an automated matching system. In 2006, PwC reviewed this automated system and determined that it remedied the material weakness PwC had found during its 2004 audit. I reviewed the same automated matching system and, based on PwC's assessment, as well as the conclusions of my own consultants, issued my recommendation in 2007. The court's Consent Order specifically stated that, where appropriate, I could rely on the attestations of AIG's outside, independent auditors. Only after my recommendation was issued in 2007 did the PCAOB select PwC for audit.

c. If you are confirmed as the Deputy Attorney General, would you favor allowing the Justice Department to "independently review" the activities of the Justice Department the same way you allowed AIG-FP to "independently review" itself? Why or why not?

RESPONSE: If I am confirmed as Deputy Attorney General, I would support the various forms of independent review to which the Justice Department currently submits. These include not only

oversight by the Congress, but also the functions of the Department of Justice's Inspector General and the Office of Professional Responsibility.

QUESTION (5): Documents released by the House Oversight and Government Reform Committee from the Federal Reserve Bank of New York ("New York Fed") reveal internal deliberations from September 2008 through May 2009. These notes provide a snapshot into the negotiations with AIG regarding the \$128 billion bailout paid for by American taxpayers. Copies of notes that appear to be made by a member of the New York Fed indicate that an AIG Audit Committee meeting in September /October 2008 was an "angry meeting" where "directors felt that were lied to 2 years ago." Further, the notes detail your involvement at AIG. Specifically, they state, "review committee [at AIG] wants to put in place but Jim Cole has been sitting on it." These notes seem to imply that AIG wanted a committee to review risky CDO transactions by AIG-FP prior to placing them in the SPV that was created to house AIG's bad assets (Maiden Lane III). The notes appear to indicate that while AIG wanted the review committee put in place to review these transactions, you were "sitting on it."

- a. **Did AIG ask for you to establish a review committee to review the CDO investments made by AIG-FP to determine their valuation prior to placing them in the Maiden Lane III SPV? If so, were you against such a valuation? Please provide a detailed description of any and all involvement in deciding to create a review committee to review that valuation of CDOs entered into by AIG-FP.**

RESPONSE: AIG did not ask me to be involved in establishing a "review committee" to review the CDO investments made by AIG-FP to determine their valuation prior to placing them in the Maiden Lane III SPV, and indeed I had no such involvement. I am not the author of the undated handwritten notes referenced in your letter, and I do not know who the author is. My interpretation of those notes, based on my best recollection of events that occurred some time ago, is that the notes refer to a different type of committee unrelated to AIG-FP's pre-Maiden Lane III investment "review committee" that is mentioned in your question. I believe that the notes refer to a committee I had recommended to ensure that disclosures to be made by AIG to its investors would be complete and accurate. At this meeting, I believe AIG indicated that it had submitted a proposal about the disclosure committee to my staff and had not yet received a response. Following the meeting, I located the proposal, reviewed it, provided comments to AIG about its provisions and returned it to the company. Thereafter AIG informed me that it had decided to change its approach to this committee and would provide me with a new proposal. It was months before AIG provided me with that new proposal, a failing I noted repeatedly in the reports I issued thereafter.

- b. **If you were asked by AIG to create such a review committee, what was your position on doing so and why?**

RESPONSE: Not applicable.

- c. **What argument would there be against allowing AIG to review the CDOs entered into by AIG-FP to determine what their actual value was?**

RESPONSE: Not applicable.

- d. **CDOs that were ultimately deposited by AIG in Maiden Lane III were redeemed by banks across the globe at 100 cents on the dollar- However, similar bad debts held by Merrill Lynch were sold to Bank of America in another structured deal backed by the Federal Reserve at only 22 cents on the dollar. Do you believe that a review committee at AIG would have found the AIG valuations to be similar comparative transactions shifted by Merrill Lynch? Why or why not?**

RESPONSE: Not applicable.

QUESTION (6): In response to question 43(a) by Senator Coburn, regarding your decision to exempt AIGFP from the Derivatives Committee you stated that, "AIG-FP engaged in thousands of derivative transactions and in order to remediate this material weakness it had to develop a robust automated system to match and evaluate the thousands of transactions it entered into each year...This could not be done manually. It would have taken years for a Derivatives Committee to review AIG-FP's derivative transactions." You added that the Derivatives Committee could review the more manageable derivative transactions entered into by other AIG entities on a transaction-by-transaction basis.

- a. **Why couldn't the Derivatives Committee review reports generated by the automated review of AIG-FP transactions?**
- b. **Couldn't you have created a system where the Derivatives Committee provided some level of independent review over AIG-FP after AIG-FP conducted an initial review of AIG-FP derivative transactions?**
- c. **Why did you put AIG-FP in charge of reviewing all AIG-FP transactions without some semblance of an independent review or oversight by the Derivatives Committee?**
- d. **In hindsight, wouldn't such a review have provided the appearance of an attempt to create a truly independent review of AIG-FP?**

RESPONSE: Please see my response to Question 4 above, which describes the rationale for recommending that the independent review of AIG-FP transactions be automated rather than manual.